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IN THE

Supreme Court of the United States

October Term, 1965

No. 1145

MATTEL, INC.,

Petitioner,

vs.

THEODORE R. DUNCAN, and TED DUNCAN, INC.,

Respondent.

Petition for Writ of Certiorari to the Supreme Court of the State of California.

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IN THE

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No. .....

MATTEL, INC.,

Petitioner,

vs.

THEODORE R. DUNCAN, and TED DUNCAN, INC.,

Respondent.

Petition for Writ of Certiorari to the Supreme Court of the State of California.

Petitioner prays that a writ of certiorari issue to review the ruling of the Supreme Court of the State of California, entered in the above case on the 22nd day of December, 1965.

Opinions Below.

The opinion of the District Court of Appeal, Second Appellate District, for the State of California, was certified for non-publication in Official Reports under (local) Rule 976. Rehearing was denied. The petition for hearing in the Supreme Court of California was denied.

Grounds for Jurisdiction.

The denial of the petition for hearing in the Supreme Court of California was made and entered on December 22, 1965; denial of rehearing in the District Court

of Appeal was made and entered November 22, 1965; the judgment of the District Court of Appeal for the Second Appellate District was made and entered on October 28, 1965, and a copy thereof is appended to this application (Appendix F). The jurisdiction of this Court is invoked under 28 U.S.C. 1257(3); Article VI, and Article I, Section 8, Clause 8, of the United States Constitution.

Question Presented for Review.

Should State Courts specifically enforce the forfeiture clause of a patent license which prohibits the licensee from dealing in unpatented competitive goods unless licensor is paid royalties thereon?

Is it material whether these or any other patents affected by the license agreement dominate their relevant market?

When some of the patents affected dominate their relevant market should State Courts specifically enforce the forfeiture clause of a patent license which prohibits the licensee from dealing in unpatented competitive goods unless licensor is paid royalties thereon?

Statutes and Federal Decisions Involved.

Article VI, paragraph 2 of the Constitution of the United States provides as follows:

> "This Constitution, and the laws of the United States which shall be made in Pursuance thereof; . . . shall be the supreme Law of the Land; and the

Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

Article I, Section 8, Clause 8, of the Constitution of the United States:

"Section. 8. The Congress shall have Power. . . . To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries";

The Sherman Act, 14 U.S.C. Section 1, *et seq.;*

The Clayton Act, 15 U.S.C. Section 14.

15 U.S.C. Section 14:

"It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease, or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, or fix a price charged therefor, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

The Patent Laws of the United States, 35 U.S.C. Section 1, and following, and particularly 35 U.S.C. §154.

§154. Contents and term of patent

Every patent shall contain a short title of the invention and a grant to the patentee, his heirs or assigns, for the term of seventeen years, of the right to exclude others from making, using, or selling the invention throughout the United States, referring to the specification for the particulars thereof. A copy of the specification and drawings shall be annexed to the patent and be a part thereof July 19, 1952, c. 950, § 1, 66 Stat. 804.

and Judicial Decisions establishing Doctrine of Misuse of Patents, as follows:

Cases Relied Upon.

Sola Electric Co. v. Jefferson Elec. Co., 317 U.S. 173 (1942);

Brulotte v. Thys Company, 379 U.S. 19 (1965).

". . . It is enough that the agreement in the abstract pushes in the direction of monopoly of non-patented articles; it is not necessary to show that it creates or tends to create an actual monopoly. The agreements themselves tell the tale." *Morton Salt Company v. Suppiger Company,* 314 U.S. 488 (1942);

MacGregor v. Westinghouse, 329 U.S. 402 (1947);

Sears Roebuck Co. v. Stiffel, 376 U.S. 225 (1964).

Reasons Relied Upon for Review on Writ of Certiorari.

1. The decision of the District Court of California (Appendix F) is either contrary to and ignores the federal law, to wit: the doctrine of misuse of Patents, which has been spelled out by the decisions of this Court, and the Sherman and Clayton Acts. The state court has subverted the Federal law to the State Law of California, in violation of Article VI of the United States Constitution.

2. The case presents Federal questions not governed by State contract severability rules, which questions have been raised by your petitioner in challenging the validity of the patent license Agreement, Exhibit A, and paragraph 6 thereof.

3. The issues presented in this case are Federal questions of unusually great public importance which the state court has decided for the first time, in that this Court has not yet determined upon the applicability of the Patent Misuse Doctrine to restrictive agreements of this type as between patentee and licensees, although the decisions of this Court uniformly and clearly hold that a restrictive agreement of this nature is invalid when applied to a third-party accused of infringement.

4. This Court has also held that a licensee may refuse to pay royalties under the patent license agreement containing a price fixing agreement in violation of the anti-trust laws.

5. Failure to issue a writ of certiorari herein will result in a forfeiture of licensee's expenditures of approximately $200,000.00 in addition to royalties paid under the agreement, in spite of a finding of diligence by licensee.

6. Further expenditures by the licensee to merchandise the licensed goods are commercially impractical while the demanded reversion is either a present threat or an imminent possibility.

Statement of the Case.

Review of the judgment of a State Court, namely, the Supreme Court of the State of California, is sought herein and the stage in the proceedings in the court of first instance and in the appellate court, at which, and the manner in which, the federal questions sought to be reviewed were raised, the method of raising them; and the way in which they were passed upon by the Court, which show that the federal question was timely and properly raised so as to give this (United States Supreme) Court jurisdiction to review the judgment on writ of certiorari are as follows:

On December 1, 1958, respondents made and entered into an agreement with petitioner, a copy of paragraph 6 of which agreement is annexed hereto as Appendix "A", wherein respondents assigned certain patent rights in a "voice box" to petitioner which provided in part as follows:

> "In the event Mattel shall manufacture or sell a different . . . voice box developed by someone other than . . . Duncan, and for which royalties are not payable to . . . Duncan hereunder, the patent rights . . . assigned by Duncan to Mattel on the . . . voice box . . . shall at the option of . . . Duncan revert to . . . Duncan."

Petitioner thereafter acquired rights to another voice reproducing device and marketed it in toys which were not economically competitive with any toys employing

the licensed "voice box." Also, petitioner's after-acquired device was substantially larger in size than the licensed device, and therefore could not be used in any of the toys equipped with the licensed device. Moreover, the claims of the licensed patents do not cover the said petitioner's after-acquired device.

Court of First Instance.

On July 21, 1960, by certified mail, counsel for respondents notified petitioner as follows:

> "With respect to the agreement which our client, Mr. Ted Duncan, entered into with you under date of December 1, 1958, Mr. Duncan has instructed us to formally notify you that inasmuch as you are manufacturing and selling a voice box developed by someone other than Mr. Duncan and for which royalties are not payable to Mr. Duncan, he exercises the option granted to him by virtue of paragraph 6 of said agreement to have all of the voice box inventions, patent applications and patents which he assigned to you in and by said agreement reverted to him, and to terminate all rights, titles and interests, conveyed and granted to you in and by said agreement with respect to Mr. Duncan's voice box . . . unless you dispute the fact that you are manufacturing and selling a voice box developed by someone other than Mr. Duncan and on which royalties are not payable to him, there does not appear to be any question of fact to be determined by arbitration."

In its "Answering Statement" (Appendix C), filed September 2, 1960, in reply to the "Demand for Arbitration," filed by respondents on August 29, 1960, be-

fore the American Arbitration Association Administrator, petitioner raised the federal questions now sought to be reviewed by writ of certiorari in the present pending petition for certiorari, in the following manner and by the following method:

> "Mattel, Inc. answers the demand for arbitration by Theodore R. Duncan as follows:
>
> "1. Answering paragraphs (a) to (f), inclusive of the demand, Mattel, Inc. states that the demand is an improper arbitration demand. Paragraph 6 of the Agreement of December 1, 1958 is not subject to arbitration.
>
> "Mattel, Inc. has not failed to exercise the diligence required in paragraph 2 of the agreement and referred to in paragraph 5.
>
> "Mattel, Inc. states further that the obligations imposd on Mattel, Inc. in paragraph 6 of the agreement dated December 1, 1958 are illegal and unenforceable, being contrary to the Anti-Trust laws of the United States since they are an attempt by Duncan to extend his patent monopoly to things not covered in his patents. The Duncan rights cover a very specific and limited form of music box.
>
> "It was not intended directly or by implication that, the definition of 'voice box', page 2 of the agreement, should, under paragraph 6 of the agreement, pre-empt the entire field of reproducing the human voice non-competitive with Duncan and exclude Mattel, Inc. from it."

The dispute under the agreement was submitted to arbitration over respondent's objections, resulting in an award on March 18, 1964 granting to respondents a

reversion of the licensed patent rights under paragraph 6 of said Exhibit "A".

This reversion was ordered despite a finding of due diligence by petitioner under paragraph 5 of the subject license.

Respondents filed a petition in the Superior Court of the State of California to confirm the award of the arbitrators (Appendix D); and said Court confirmed the award on June 4, 1964 (Appendix E.)

Petitioner has urged, at all levels of the proceedings below that the contract provisions of paragraph 6 (Appendix A) in question were and are not a proper subject of arbitration for the reason that said provision is in violation of the doctrine of public policy proclaimed by this Court, and the Patent Laws and the Antitrust laws of the United States.

Argument.

Paragraph 6 of the Patent License Agreement or Patent Assignment Agreement in question is of the type condemned by a well-established line of cases including:

1. *Morton Salt Co. v. G. S. Suppiger Co.,* 314 U.S. 488 (1942).

Under that doctrine a patent may not be enforced while the privilege of its monopoly is being abused by a restrictive provision such as paragraph 6 of the agreement in question herein.

It has further been held that "a state by applying its own law of specific performance may not compel the performance of a contract contemplating violation of the federal land laws."

2. *Sola Electric Co. v. Jefferson Electric Co.*, 317 U.S. 173 (1942), which held that anyone sued may set up as a defense that the license agreement is in violation of the Sherman Act *ibid.*

Specific performance has been decreed against your petitioner based upon an arbitration proceeding commenced while petitioner was exercising reasonable diligence under other paragraphs of the agreement, namely 2 and 5 in the manufacture and sale of the licensed voice units. Petitioner's sole fault was therefore its manufacture and sale of a competing voice unit outside the scope of the respondent's patents referred to in the licensed patents.

The question presented is therefore whether such a restrictive provision above is to be specifically enforced without reference to Federal law including the Sherman and Clayton Acts and the Patent Laws under the Constitutional grant.

The challenged contractual provision prevents the petitioner from engaging freely in the manufacture and sale of competitive goods on pain of reversion unless its licensor, is paid royalty on such competitive goods whether they are patented or not.

See also *Brulotte v. Thys Co.*, 379 U.S. 29 (1965).

As is further stated in the *Sola* case:

> "[3] It is familiar doctrine that the prohibition of a federal statute may not be set at naught, or its benefits denied, by state statutes or state common law rules. It [sic] such a case our decision is not controlled by Erie Railroad v. Tonpkins, 304 U.S. 64. There we followed state law because it was the law to be applied in the federal courts.

But the doctrine of that case is inapplicable to those areas of judicial decision within which the policy of the law is so dominated by the sweep of federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than by local law. Royal Indemnity Co. v. United States, 313 U. S. 289, 296; Prudence Corp. v. Geist, 316 U.S. 89, 95; Board of Comm'rs v. United States, 308 U.S. 343, 349-350; cf. O'Brien v. Western Union Telegraph Co., 133 F.2d 539, 541. When a federal statute condemns an act as unlawful the extent and nature of the legal consequences of the condemnation, though left by the statute to judicial determination, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted. To the federal statute and policy, conflicting state law and policy must yield. Constitution, Art. VI, cl. 2; Awotin v. Atlas Exchange Bank, 295 U.S. 209; Dietrick v. Greaney, 309 U. S. 190, 200-01.

"[4] . . . A state by applying its own law of specific performance of a contract contemplating violation of a contract contemplating violation of the federal land laws, Anderson v. Carkins, 135 U.S. 483.

"[5] anyone sued upon a contract may set up as a defense that it is a violation of the Sherman Act. Bement v. National Harrow Co., 186 U.S. 70, 88. And it has proceeded on the assumption that whether the parties to an agreement in violation of the Act are in pari delicto is a question

of federal, not state, law. Harriman v. Northern Securities Co., 197 U.S. 244; Eastman Co. v. Southern Photo Co., 273 U.S. 359, 376-78. It decided in Continental Wall Paper Co. v. Voight & Sons Co., 212 U.S. 227, that a vendee of goods purchased from an illegal combination in pursuance of an illegal agreement, both in violation of the Sherman Act, can plead the illegality in defense to a suit for the purchase price. This decision went much further than it is necessary to go here to conclude that petitioner may assert the illegality of the price-fixing agreement and may offer any competent evidence to establish its illegality, including proof of the invalidity of the patent.

"Local rules of estoppel which would fasten upon the public as well as the petitioner the burden of an agreement in violation of the Sherman Act must yield to the Act's declaration that such agreements are unlawful, and to the public interest precludes the enforcement of such unlawful agreements. Cf. Morton Salt Co. v. Suppiger Co., 314 U.S. 488, 492-93 [52 USPQ 30, 32-33].

"Reversed."

3. And as stated in the *Brulotte* case (*op. cit. supra*):

"[4] A patient empowers the owner to exact royalties as high as he can negotiate with the leverage of that monopoly. But to use that leverage to project those royalty payments beyond the life of the patent is analogous to an effort to enlarge the monopoly of the patent by tieing the sale or use of the patented article to the purchase or use of unpatented ones. See Ethyl Gasoline Corp. v.

United States, 309 U.S. 436, 44 USPQ 614; Mercoid Corp. v. Mid-Continent Inv. Co., 320 U.S. 661, pp. 664-665, 60 USPQ 21, 24, and cases cited. The exaction of royalties for use of a machine after the patent has expired is an assertion of monopoly power in the post-expiration period when, as we have seen, the patent has entered the public domain. We share the views of the Court of Appeals in Ar-Tik Systems, Inc. v. Dairy Queen, Inc., 302 F.2d 496, 510, 133 USPQ 109, 119, that after expiration of the last of the patents incorporated on the machines 'the grant of patent monopoly was spent' and that an attempt to project it into another term by continuation of the licensing agreement is unenforceable.

"Reversed."

4. *MacGregor v. Westinghouse, Electric and Mfg. Co.*, 329 U.S. 402, 407.

"For the reasons stated in today's Katsinger opinion we hold that the covenant to pay royalties was not severable from the covenant to sell at fixed prices. Since MacGregor invoked federal law to sustain his challenge to the validiy of the patent, the alleged misuse of the patent, and . . . .his contentions raised federal questions not governed by state estoppel or contract severability rules". *MacGregor v. Westinghouse Electric and Mfg. Co.*, 329 U.S. 402, 407.

"Illegality renders an agreement unenforcible. (Citation omitted). An agreement which is against public policy is illegal. Since the public policy here required to be ascertained relates to patents,

the federal rule in respect of public policy governs." *MacGregor v. Westinghouse Co.*, 329 U.S. 402, 407; *O'Connor v. Hudson River Day Line*, 269 App. Div. 960, aff'd 296 N.Y. 501; *Adler v. Zimmerman*, 233 N.Y. 431, 438. We find the public policy in the Constitution, the statutes and judicial decisions. (Citations omitted). *Hazeltine Research, Inc. v. DeWald Radio Mfg. Corp.*, N.Y. Supreme Court, Special Term, New York County, 79 U.S.P.Q. 446, 84 So. 2d 597.

5. *Sears, Roebuck Co. v. Stiffel*, 376 U.S. 225 (1964).

"Once the patent issues, it is strictly construed, (citation omitted), it cannot be used to secure any monopoly beyond that contained in the patent (citation omitted), the patentee's control over the product when it leaves his hands is sharply limited (citation omitted) and the patent monopoly may not be used in disregard of the anti-trust laws (citation omitted)." *Sears, Roebuck and Company v. Stiffel Co.* (1964), 376 U.S. 225.

Conclusion.

We respectfully urge that in the public interest and in the interest of uniformity this Court should review the judgment here involved.

Dated: March 21, 1966.

Respectfully submitted,

ALBERT M. HERZIG,

Attorney for Petitioner.

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APPENDIX A.

Paragraph 6 of Patent License Agreement.

6. OTHER MUSIC BOXES AND VOICE BOXES

In the event Mattel shall manufacture or sell a different music box or a different voice box developed by someone other than Theodore R. Duncan, and for which royalties are not payable to Theodore R. Duncan hereunder, the patent rights now or hereafter assigned by Duncan to Mattel on the disc-type music box or the voice box, as the case may be, shall at the option of Theodore R. Duncan revert to Theodore R. Duncan and upon such reversion all Mattel's rights and obligations with respect to said music box or voice box, as the case may be, shall thereupon terminate and end and Theodore R. Duncan shall thereafter have the right to manufacture, use, sell and exploit the same and to license others to do likewise. Music boxes and voice boxes for the purposes of this paragraph shall be as defined herein. Any dispute under this paragraph shall be the subject of arbitration as herein provided.

APPENDIX B.

Demand for Arbitration
American Arbitration Association, Administrator
Commercial Arbitration Tribunal

To: (Name) Mattel, Inc.

(Address) 5432 West 102nd Street, Los Angeles 45, Calif. (of party upon whom the Demand is made)

The undersigned, a Party to an Arbitration Agreement contained in or relating to a written contract, dated December 1, 1958, which agreement provides as follows: (Quote Arbitration Clause)

> See provisions of paragraphs 5 and 6 of said agreement attached hereto.

hereby demands arbitration of the following dispute which is subject to arbitration thereunder.
Claim or Relief Sought: (amount if any)

> See Exhibit 1 attached hereto.

You are hereby notified that a copy of our Arbitration Agreement and of this Demand is being filed with the American Arbitration Association, Administrator, with the request that it immediately put its Rules into effect and furnish each Party with an identical list of names of persons taken from the Panels maintained by the Association. When the list is received, you are hereby requested to proceed with the selection of three Arbitrator(s) in accordance with said Rules. *Under Rule III Section 7 you may file an answering statement*

within seven days after the mailing of notice from the Administrator.

Dated: August 29, 1960.

Signed Mason & Graham.

Title Attorneys for Theodore R. Duncan

Address 811 West Seventh Street, Los Angeles 17, Calif.

Telephone MAdison 2-2184.

A copy of this Demand must be filed with the American Arbitration Association and the administrative fee paid, as provided in the Rules, in order to institute proceedings under the Rules.

EXHIBIT 1

(a) Whether Mattel, Inc., has manufactured or sold and/or is manufacturing or selling a different voice box developed by someone other than Theodore R. Duncan and for which royalties are not payable to Theodore R. Duncan under said agreement dated December 1, 1958;

(b) Whether the patent rights on the voice box inventions identified in Exhibit A-II, forming a part of said agreement of December 1, 1958, assigned by Theodore R. Duncan to Mattel, Inc., in and by said agreement, as well as any other patent rights on said voice box inventions which have been assigned by Theodore R. Duncan to Mattel, Inc., since December 1, 1958, shall revert to Theodore R. Duncan pursuant to the provisions of paragraph 6 of said agreement;

(c) Whether, as of the date of the reversion, the rights and obligations of Mattel, Inc., in and to said patent rights relating to said voice box inventions shall terminate, pursuant to the provisions of paragraph 6 of said agreement of December 1, 1958;

(d) Whether Theodore R. Duncan shall, upon and after said reversion, have the right to manufacture, use, sell and exploit said patent rights and to license others to do likewise, pursuant to the provisions of paragraph 6 of said agreement.

(e) Whether Theodore R. Duncan shall have the right to purchase from Mattel, Inc., and whether Mattel, Inc., shall be required to sell to Theodore R. Duncan, tools, dies, jigs, machinery in good working condition, parts, inventory, work in progress and completed items and supplies, relating to said voice box inventions, pursuant and subject to the provisions of paragraph numbered 9 of said agreement dated December 1, 1958, and, if so, what items said purchase and sale shall comprise, and whether Mattel, Inc., shall pay the sales tax thereon.

(f) Whether, for the portion of the year 1960 up to the time of said reversion, Mattel, Inc., shall pay to Theodore R. Duncan, a proportionate share of the minimum royalties provided, in paragraph 3(b) of said agreement of December 1, 1958, to be paid to Theodore R. Duncan for the year 1960.

The value of the property subject to this arbitration has not been determined but it exceeds $10,000.00.

July 21, 1960

CERTIFIED

Mattel, Inc.
5432 West 102nd Street
Los Angeles 45, California

Gentlemen:

With respect to the agreement which our client, Mr. Ted Duncan, entered into with you under date of December 1, 1958, Mr. Duncan has instructed us formally to notify you that inasmuch as you are manufacturing and selling a voice box developed by someone other than Mr. Duncan and for which royalties are not payable to Mr. Duncan, he exercises the option granted to him by virtue of paragraph 6 of said agreement to have all the voice box inventions, patent applications and patents which he assigned to you in and by said agreement, reverted to him, and to terminate all rights, titles and interests conveyed and granted to you in and by said agreement with respect to Mr. Duncan's voice box. We therefore demand, on behalf of Mr. Duncan, that you reassign and reconvey to him all the rights, titles and interests in and to said inventions, applications and patents within thirty days from the date of this letter; or, if you desire first that this matter be referred to the American Arbitration Association for determination, Mr. Duncan requests that you so advise him promptly. However, unless you dispute the fact that you are manufacturing and selling a voice box developed by someone other than Mr. Duncan and for which royalties are not payable to him, there does not appear to be any question of fact to be determined by arbitration.

Very truly yours,

of Mason & Graham

CM/js

cc/Mr. Albert M. Herzig
Mr. Ted Duncan

APPENDIX C.

Answering Statement and Counter Demand for Arbitration

American Arbitration Association, Administrator
Commercial Arbitration Tribunal

To: Mason & Graham
Attorneys for Theodore R. Duncan
811 West Seventh Street, Los Angeles 17, California.

ANSWERING STATEMENT

Mattel, Inc. answers the demand for arbitration by Theodor R. Duncan as follows:

1. Answering paragraphs (a) to (f), inclusive, of the demand, Mattel, Inc. states that the demand is an improper arbitration demand. Paragraph 6 of the Agreement of December 1, 1958 is not subject to arbitration. Mattel, Inc. has not failed to exercise the diligence required in paragraph 2 of the agreement and referred to in paragraph 5. Mattel, Inc. states further that the obligations imposed on Mattel, Inc. in paragraph 6 of the agreement dated December 1, 1958 are illegal and unenforceable, being contrary to the Anti-Trust laws of the United States since they are an attempt by Duncan to extend his patent monopoly to things not covered in his patents. The Duncan patent rights cover a very specific and limited form of music box. It was not intended directly or by implication that the definition of "voice box", page 2 of the agreement should, under paragraph 6 of the agreement, pre-empt the entire field of reproducing the human voice non-competitive with Duncan and exclude Mattel, Inc. from it.

COUNTER DEMAND FOR ARBITRATION
CLAIM OR RELIEF SOUGHT:

2. Require Theodore R. Duncan to promptly and fully disclose and assign to Mattel, Inc. all his right, title and interest in and to any further music box and voice box inventions which he conceived solely or jointly with others as provided in paragraph 1 of the agreement of December 1, 1958, and referred to in his letter to Mattel, Inc. dated May 13, 1960.

3. Enjoin Theodore R. Duncan from seeking to enforce any reversion and award a ruling that he is not entitled to enforce such reversion.

Herzig & Walsh

Dated: Sept. 2, 1960.

Signed /s/ ALBERT M. HERZIG
Title: Attorneys for Mattel, Inc.
Address: 727 West Seventh Street,
Los Angeles 17, California
Telephone: MAdison 7-3565

APPENDIX D.

Award of Arbitrator(s).

American Arbitration Association Administrator.
Commercial Arbitration Tribunal

In the Matter of the Arbitration between Theodore R. Duncan and Mattel, Inc.

We, The Undersigned Arbitrator(s), having been designated in accordance with the Arbitration Agreement entered into by the above-named Parties, and dated December 1, 1958 and having been duly sworn and having duly heard the proofs and allegations of the Parties, Award, as follows:

(A) THEODORE R. DUNCAN, hereinafter sometimes referred to as DUNCAN, is entitled, under the provisions of Paragraph "6. OTHER MUSIC BOXES AND VOICE BOXES" of the Agreement entered into by and between DUNCAN and MATTEL, INC., hereinafter sometimes referred to as MATTEL, on the 1st day of December, 1958, to reversion of the voice box patent rights which were assigned to MATTEL by DUNCAN under said Agreement. This reversion shall be effective as of the date of this Award; and MATTEL shall within ten days after the date of this AWARD, prepare and execute and deliver to DUNCAN a written assignment reassigning to DUNCAN the entire right, title and interest in and to said patents and inventions of voice box which were assigned by DUNCAN to MATTEL under said Agreement.

(B) DUNCAN shall purchase and MATTEL shall sell to DUNCAN all tools, dies, jigs, machinery in good working conditions, parts inventory, work in progress, completed items and supplies, relating to the DUNCAN voice box, in accordance with the provisions of Paragraph 9 of said Agreement. This sale and delivery shall take place within thirty days of the date of this Award. If the parties cannot mutually agree upon the sales price, they shall promptly appoint an appraiser, as provided for in Paragraph 9 of said Agreement, who shall determine the sales price. The goods to be purchased properly inventoried shall be available at MATTEL'S delivery dock for delivery to DUNCAN within said thirty day period, and DUNCAN shall pay to MATTEL the agreed or appraiser's sales price, plus sales tax, if any is required by law, by U.S. money or certified or cashier's check.

(C) Within thirty days from the date of this Award MATTEL shall pay to DUNCAN all unpaid minimum royalties for the DUNCAN voice box under said Agreement to DUNCAN to and including the date of this Award.

(D) The administrative fees and expenses of the American Arbitration Association which total $386.85 shall be borne equally by the parties. Therefore, MATTEL shall pay to DUNCAN the sum of $101.58 for MATTEL'S portion of the fees and expenses previously advanced by DUNCAN to the Association, and MATTEL shall pay to the American Arbitration Association

the sum of $30.00 for the balance of their one-half share of the fees and expenses still due the Association.

(E) This Award is in full settlement of all claims and counterclaims submitted by either party against the other in this arbitration.

R. Welton Whann
John B. Ruth
Paul K. Beemer

Dated: March 18, 1964.
Case No. C-15085 LOS-C-61-60.

APPENDIX E.

Order Confirming Award and Judgment Thereon.

Brown and Altshuler
Mason and Graham
9301 Wilshire Boulevard
Beverly Hills, California
CRestview 5-4475
BRadshaw 2-5339
Attorneys for Petitioners.

Superior Court of the State of California, for the County of Los Angeles.

Theodore R. Duncan and Ted Duncan, Inc., Petitioners, vs. Mattel, Inc., Respondent. No. 836346.

The motion of petitioners Theodore R. Duncan and Ted Duncan, Inc. for an order confirming award of arbitrators made March 18, 1964 before the American Arbitration Association, Administrator, Case No. C-15085 LOS-C-61-60, and the motion of respondent Mattel, Inc. for an order vacating said award having come on regularly for hearing before the Honorable Leon T. David, Judge presiding in Department 66 of the above entitled court on April 27, 1964 upon notice duly and regularly served, petitioners Theodore R. Duncan and Ted Duncan, Inc. appearing by Brown and Altshuler and Leo Altshuler their counsel, and respondent Mattel, Inc. appearing by Herzig and Walsh, Albert M. Herzig and Henry R. Blackburn, its counsel, and documentary evidence having been introduced and the matter having been argued and submitted and good cause appearing therefor,

It is Hereby Ordered as follows:

1. The motion of petitioners Theodore R. Duncan and Ted Duncan, Inc. for an order confirming said Award of Arbitrators is granted.

2. The motion of respondent Mattel, Inc. for an order vacating said Award of Arbitrators is denied.

3. The award of said arbitrators in American Arbitration Association proceedings #C-15085 LOS-C-61-60 dated March 18, 1964 is hereby confirmed and Judgment of this Court is hereby given that each of the parties shall perform and comply with the requirements of said award which award in words and in figures is as follows, to-wit:

(a) THEODORE R. DUNCAN, hereinafter sometimes referred to as DUNCAN, is entitled, under the provisions of Paragraph "6. OTHER MUSIC BOXES AND VOICE BOXES" of the Agreement entered into by and between DUNCAN and MATTEL, INC., hereinafter sometimes referred to as MATTEL, on the 1st day of December, 1958, to reversion of the voice box patent rights which were assigned to MATTEL by DUNCAN under said Agreement. This reversion shall be effective as of the date of this Award; and MATTEL shall within ten days after the date of this Award, prepare and execute and deliver to DUNCAN a written assignment reassigning to DUNCAN the entire right, title and interest in and to said patents and inven-

tions of voice box which were assigned by DUNCAN to MATTEL under said Agreement.

(B) DUNCAN shall purchase and MATTEL shall sell to DUNCAN all tools, dies, jigs, machinery in good working condition, parts inventory, work in progress, completed items and supplies, relating to the DUNCAN voice box, in accordance with the provisions of Paragraph 9 of said Agreement. This sale and delivery shall take place within thirty days of the date of this Award. If the parties cannot mutually agree upon the sales price, they shall promptly appoint an appraiser, as provided for in Paragraph 9 of said Agreement, who shall determine the sales price. The goods to be purchased properly inventoried shall be available at MATTEL's delivery dock for delivery to DUNCAN within said thirty day period, and DUNCAN shall pay to MATTEL the agreed or appraiser's sales price, plus sales tax, if any is required by law, by U.S. money or certified or cashier's check.

(C) Within thirty days from the date of this Award MATTEL shall pay to DUNCAN all unpaid minimum royalties for the DUNCAN voice box under said Agreement to DUNCAN to and including the date of this Award.

(D) The administrative fees and expenses of the American Arbitration Association which total $386.85 shall be borne equally by the parties.

Therefore, MATTEL shall pay to DUNCAN the sum of $101.58 for MATTEL'S portion of the fees and expenses previously advanced by DUNCAN to the Association, and MATTEL shall pay to the American Arbitration Association the sum of $30.00 for the balance of their one-half share of the fees and expenses still due the Association.

(E) This Award is in full settlement of all claims and counterclaims submitted by either party against the other in this arbitration.

5. Petitioners are further awarded their costs of suit in the amount of $28.11.

Dated: June 4, 1964.

Judge of the Superior Court

APPENDIX F.

Opinion of the District Court of Appeals.

In the District Court of Appeal of the State of California, Second Appellate District, Division One.

Theodore R. Duncan, and Ted Duncan, Inc., Petitioners and Respondents, v. Mattel, Inc., Respondent and Appellant. Civil No. 28957.

Filed: Oct. 28, 1965.

Appeal from a judgment of the Superior Court of Los Angeles County. Leon T. David, Judge. Affirmed.

Herzig & Walsh, and Albert M. Herzig for Respondent and Appellant Mattel, Inc.

Brown & Altshuler, Mason I. Graham, Leo Altshuler, Collins Mason, and James J. Brown for Petitioners and Respondents Theodore R. Duncan and Ted Duncan, Inc.

Theodore R. Duncan and Ted Duncan, Inc. (who will be referred to as Duncan) made an agreement whereby Duncan assigned patent rights in a "voice box" to Mattel, Inc. A dispute under the agreement was submitted for arbitration and the arbitrators made an award that Duncan is entitled, under provisions of the agreement, to reversion of the patent rights. Duncan then petitioned the superior court to confirm the award, and Mattel responded, requesting that the court vacate the award. Mattel appeals from the "order confirming award and judgment thereon."

Appellant (Mattel) contends that certain provisions of the agreement were illegal restraints on trade and therefore not properly arbitrable.

For approximately 5 years prior to December 1, 1958, Duncan had been engaged in the manufacture and sale of a voice box upon which he had various patents. (The voice box is a miniature recording device which is inserted into a toy such as a doll or telephone and reproduces the human voice by mechanical means.) On December 1, 1958, Duncan and Mattel made a 13-page agreement whereby Duncan assigned the patents to Mattel and sold his machinery and inventory to Mattel, and Mattel agreed to manufacture and sell voice boxes and to pay certain royalties to Duncan. (The agreement also refers to a disc-type music box which is not involved in the present action.)

Paragraph 2 of the agreement provides that Mattel shall manufacture and sell the voice box in good faith and with reasonable diligence. Paragraph 3 provides for payment to Duncan of a minimum annual royalty of $5,000 on the sale of voice boxes commencing in 1960. Paragraph 5, under the heading "REVERSION," provides as follows: "In the event that Mattel shall fail to exercise the diligence in the sale and distribution as required by paragraph 2 hereof, or in the event that the royalties on . . . the voice boxes as referred to in paragraph 3 . . . fall below the minimum therein set forth, then . . . the matter shall be referred to arbitration. . . . If, in the arbitration it shall be determined that MATTEL has not exercised the diligence required by paragraph 2, the deficiency shall be specified and a reasonable time for compliance by MATTEL shall be allowed. In the event MATTEL shall fail to comply with the arbitration award as to the exercise of diligence, there shall be a reversion to . . . DUNCAN at his option of . . . the voice box . . . together with all patent

or other rights transferred hereunder. . . . And DUNCAN shall thereafter have the right to manufacture, use, sell, and exploit same or to license others to do likewise. . . . Reversion shall be the only remedy applicable to a failure on the part of MATTEL to exercise due diligence in the marketing and the distribution of the . . . voice box. . . ."

Paragraph 6 of the agreement provides as follows: "In the event MATTEL shall manufacture or sell a different . . . voice box developed by someone other than . . . DUNCAN, and for which royalties are not payable to . . . DUNCAN hereunder, the patent rights . . . assigned by DUNCAN to MATTEL on the . . . voice box . . . shall at the option of . . . DUNCAN revert to . . . DUNCAN. . . . Any dispute under this paragraph shall be the subject of arbitration. . . ."

Paragraph 8 provides for the sale by Duncan to Mattel of tools, dies, jigs, machinery and inventory which had been used by Duncan in the production of voice boxes, and paragraph 9 provides that Dundan shall repurchase such items in the event of a reversion of the patents to Duncan.

According to Duncan't petition in the present case, a dispute under paragraphs 5 and 6 of the agreement was submitted to the American Arbitration Association on August 29, 1960; 3 arbitrators were appointed; the arbitrators heard evidence presented by both parties; and, on March 18, 1964, the arbitrators made an award. Paragraph (A) of the award provides that Duncan is entitled, under the provisions of paragraph 6 of the agreement, to reversion of the voice box patent rights which were assigned under the agreement. Paragraph (B) provides that Duncan shall repurchase all tools,

dies, jigs, machinery and inventory sold to Mattel under the agreement. Paragraph (C) provides that Mattel shall pay to Duncan all unpaid minimum royalties due under the agreement. Paragraph (D) apportions the expenses of the arbitration between the parties, and paragraph (E) provides that the award is in full settlement of all claims and counterclaims submitted by either party in the arbitration.

Mattel filed a "response" to the petition wherein Mattel in substance admits the making of the agreement, the submission of the matter to the arbitrators, and the making of the arbitration award. There are other allegations to the effect that Mattel filed documents with the arbitrators claiming that paragraph 6 of the agreement was an illegal restraint of trade under federal and state law and therefore not arbitrable, and that Mattel has invested $75,000 in developing and marketing the voice box and $20,000 in perfecting Duncan's patents, in addition to the $90,000 which it paid Duncan for the tools, machinery and inventory. It is further alleged that Mattel will present the record of the arbitration proceedings to the court.[1]

In opposition to Duncan's motion to confirm the award (and in support of Mattel's petition to vacate the award), Mattel filed an affidavit of its vice-president which states, among other things, that the above-mentioned amounts were invested by Mattel in purchasing equipment from Duncan and in developing and market-

[1]The record of the arbitration proceedings was presented to the trial court. In its notice to prepare transcripts on appeal, Mattel states that said arbitration records are not to be copied, but that the original exhibit may be transferred to the reviewing court. The exhibit has not been transferred to the court.

ing the voice box. In reply thereto, Duncan filed an affidavit which includes the following statements: In the 5-year period preceding execution of the agreement, Duncan manufactured and sold 1,309,789 voice boxes in 1954, 2,192,699 in 1955, 1,011,292 in 1956, 738,666 in 1957, and 779,895 in 1958. It was admitted by Mattel in the arbitration proceedings that when the agreement was executed (on December 1, 1958) Mattel did not reveal to Duncan that Mattel had been developing a voice box (referred to as the "Ryan voice box"). After the agreement was executed, Mattel commenced selling the Ryan voice box in addition to the Duncan voice box. In the 5-year period following execution of the agreement, sales by Mattel of the Duncan voice box were as follows: 205,625 boxes in 1959, 48,958 in 1960, 44,349 in 1961, 7,840 in 1962, and 7,614 in 1963. The earned royalties on the Duncan voice box decreased proportionately, and were $190.35 for the year 1963. Mattel did not pay Duncan the accrued minimum royalties ($5,000 per year) due under the agreement until the day before the arbitration hearing. Mattel is no longer using or selling the Duncan voice box.

Mattel contends that the provisions of paragraph 6 of the agreement are an illegal restraint of trade and therefore are not properly arbitrable.[2]

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[2]In the arbitration proceedings, Duncan sought reversion of his patent rights under paragraphs 5 and 6. (Paragraph 5 provides for reversion if Mattel does not exercise due diligence in the manufacturer and sale of the Duncan voice box. Paragraph 6 provides for reversion if Mattel manufactures other voice boxes upon which royalties are not payable to Duncan.) In the trial court, and on appeal, the parties have made contentions as to whether or not the arbitrators found "due diligence" by Mattel. Paragraph (A) of the award specifically states that Duncan is entitled to reversion under paragraph 6 of the agreement (i.e., because Mattel manufactured and sold other voice boxes). Although

Paragraph 6 provides that Duncan's patents shall revert to Duncan in the event that Mattel manufactures or sells a different voice box developed by someone other than Duncan and for which royalties are not payable to Duncan. Mattel construes that paragraph as precluding the manufacture and sale of other voice boxes by Mattel. The express language of the paragraph does not require Mattel to manufacture or sell the Duncan voice box, and does not preclude Mattel from manufacturing or selling other voice boxes. It merely provides for reversion of Duncan's patent rights in such event.

Mattel also argues that the provisions of paragraph 6 permit Duncan to extend his patent rights so as to restrain trade in other voice boxes not included within said patent rights. (According to Mattel, the Ryan voice boxes are "concededly outside the scope of the Duncan patents.") Duncan argues, to the contrary, that Mattel is restraining trade by keeping the Duncan voice boxes in "moth balls" while marketing the Ryan voice boxes at lucrative profits, and that the provisions of paragraph 6, by providing for the return to Duncan of his patents, would encourage, rather than stifle, competition.

In *King v. Gerold,* 109 Cal. App. 2d 316 [240 P. 2d 710], Gerold invented a house trailer of a particular design. He licensed King to manufacture and sell the trail-

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paragraph (E) of the award states that the award is in full settlement of all claims in the proceedings (which would include Duncan's claim to reversion under paragraph 5 for lack of "due diligence"), this would not appear to be a finding of lack of due diligence because paragraph 5 of the agreement expressly provides that if the arbitrators find a lack of due diligence, such deficiency *shall be specified and a reasonable time for compliance by Mattel shall be allowed.* The award does not specify any deficiency as to Mattel's diligence or refer to Mattel's diligence.

er in return for payment of a royalty. The licensing agreement provided that if the license was not renewed after 6 months, King should cease to produce the trailer in any manner. King contended, as does Mattel in the present case, that the agreement constituted a restraint of trade in violation of section 16600 of the Business and Professions Code. In answer to that contention, it was said (p. 318): "The argument . . . fails to consider the terms of the writing. Appellant [King] is not thereby prohibited from carrying on his lawful business of manufacturing trailers but is barred merely from manufacturing and selling trailers of the particular design and style invented by respondent [Gerold]. . . ." (See *Del Riccio v. Photochart,* 124 Cal. App. 2d 301, 317 [268 P. 2d 814].) In the present case, as previously indicated, the agreement operates only to preclude Mattel from manufacturing voice boxes of the particular design invented by Duncan should Mattel elect to produce other voice boxes (such as the Ryan voice box). Furthermore, Mattel apparently was developing the Ryan voice box at the time it negotiated the agreement with Duncan, and did not disclose that fact to Duncan; and, as Duncan argues, return of the patent rights would appear to encourage competition by enabling Duncan to produce and sell his voice box. In the circumstances, it cannot be said that the agreement which the parties made is illegal.

In further support of its contention that the agreement is an illegal restraint of trade, Mattel cites two California cases (*Hunter v. Superior Court,* 36 Cal. App. 2d 100 [97 P. 2d 492], and *Pacific Wharf etc. Co. v. Dredging Co.,* 184 Cal. 21 [192 P. 847]), and several federal anti-trust law decisions. In the *Hunter*

case, the agreement expressly prohibited one party from manufacturing *any* machine similar to the machine to be manufactured under the agreement. In the *Pacific Wharf* case, the agreement expressly prohibited one party from engaging in the dredging business in certain harbors. The federal decisions concerned agreements which expressly prohibited the manufacture of other products or expressly required payment of royalties on other products so as, in effect, to enable one party to control an entire business contrary to the interest of the public welfare. In the present case, the agreement does not prohibit Mattel from manufacturing other voice boxes, does not require that Mattel pay royalties on other voice boxes, and does not operate so as to give Duncan control over the business of manufacturing and selling voice boxes. The agreement gives Mattel an option to manufacture and sell other voice boxes and provides, upon Mattel's election to do so, that the rights in the particular voice box designed by Duncan shall revert to Duncan. Reversion of Duncan's rights is the only protection given to Duncan by the terms of the agreement, and, as previously stated, such reversion would tend to encourage rather than to stifle competition. "[I]f the public welfare be not involved and the restraint upon one party be not greater than protection to the other requires, the contract will be sustained although it in some degree may be said to restrain trade." (*Great Western etc. v. J. A. Wathen D. Co.*, 10 Cal. 2d 442, 448-449 [74 P. 2d 745].)

The agreement does not illegally restrain trade and was arbitrable.

The judgment is affirmed.

Wood, *P. J.*

We concur:

Fourt, *J.*

Lillie, *J.*

Certified for non-publication in Official Reports under Rule 975.

Wood, *P. J.*

Fourt, *J.*

Lillie, *J.*